

Airline Industry Consolidation— Myth and Reality

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Industry Consolidation— Moving to Fewer/Bigger Airlines??

- *Consolidation trend NOT isolated mergers*
- *NOT fixing specific airlines with unprofitable capacity*
- 1--Is it happening now? is it inevitable?
- 2--Why suddenly the industry's #1 topic?
- 3--Good for industry growth? consumers?

“Fewer/Bigger Airlines” and growth forecasts
Near Term>>Productivity
Medium Term>>Capital Allocation
Longer Term>>Dynamic Competition

Three key arguments for Airline Industry Consolidation

① **Productivity (scale/scope economies):**

Fewer/Bigger Airlines would be more efficient

② **“Natural”/”intuitive”**

We have more airlines than we need;

All industries eventually consolidate;

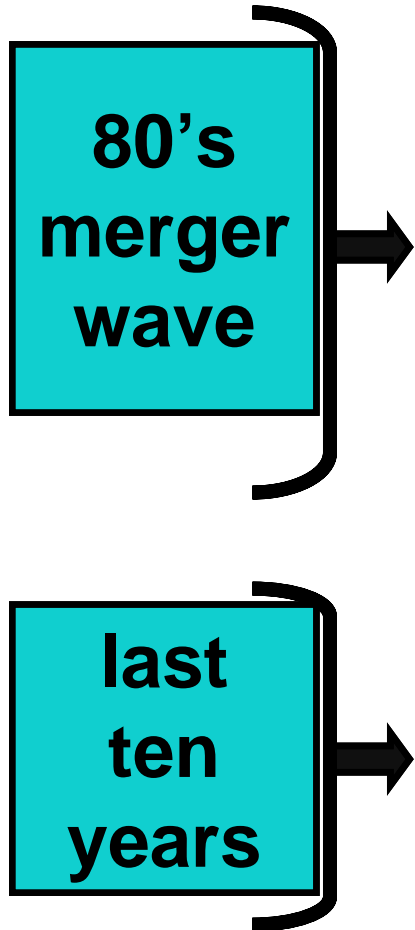
recent observed US merger experience

③ **Cross-border breakthrough**

Nationality restricts productivity/capital efficiency

Airlines should be treated same as soda

Merger track record is awful



SUCCESSFUL	WEAK/FAILURES
L	80: PA/NA
	82: TI/CO
86: TW/OZ	87: CO/PE/NY/FL
86: NW/RC	87: AA/OC
87: WN/MC	87: DL/WA
	87: CO/EA
	88: US/PI/PS
94: WN/KN	00: AA/QQ/TW
	00: UA/US
	00: AC/CP

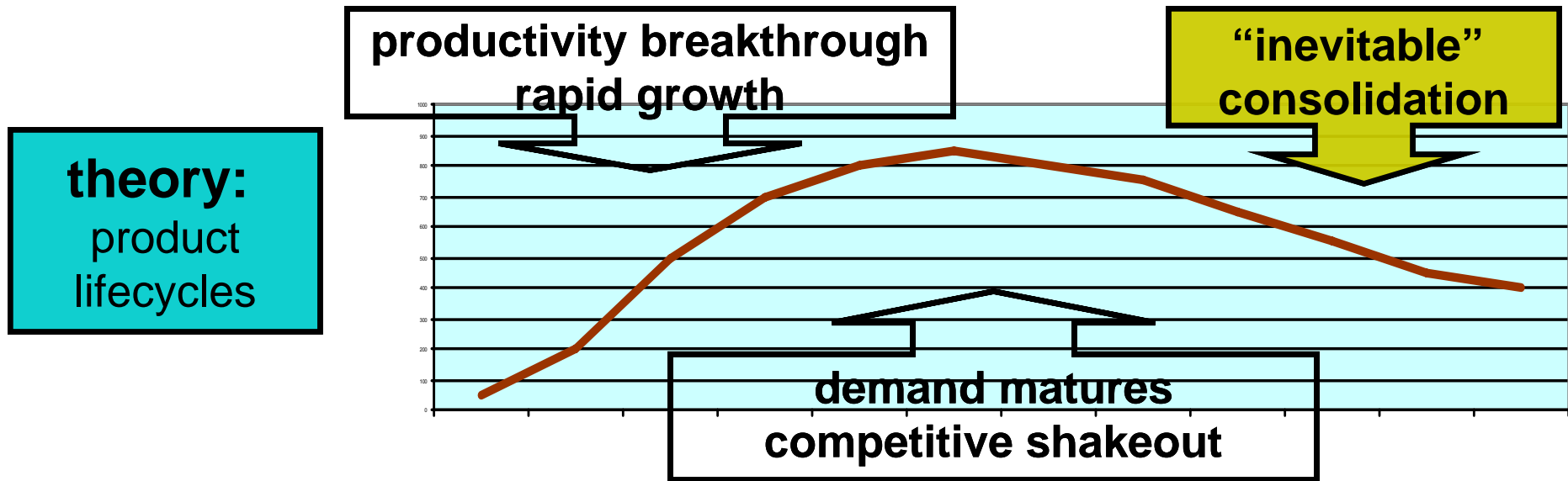
US Consolidation talk focusing on least promising mergers

Quasi-Restructuring --bankruptcy-type asset fixes	US-HP WN-MC	LH-LX
Hub Consolidation --fix old regulatory distortions	TW-OZ NW-RC	CX-KA AF-IT
Efficiencies/ Synergies --scale/end-to-end network links	US-PS DL-WA	SR-SN KL-AZ
Strongly anti-competitive --sustained by entry barriers		BA-BR KL-AF

Size doesn't drive profitability (and becoming less important)
Mergers expensive and risky (especially for big airlines)

Hypothetical: **UA+CO** --need \$3-4bn in synergies to justify risk

“Inevitable Consolidation” argument doesn’t apply to airlines

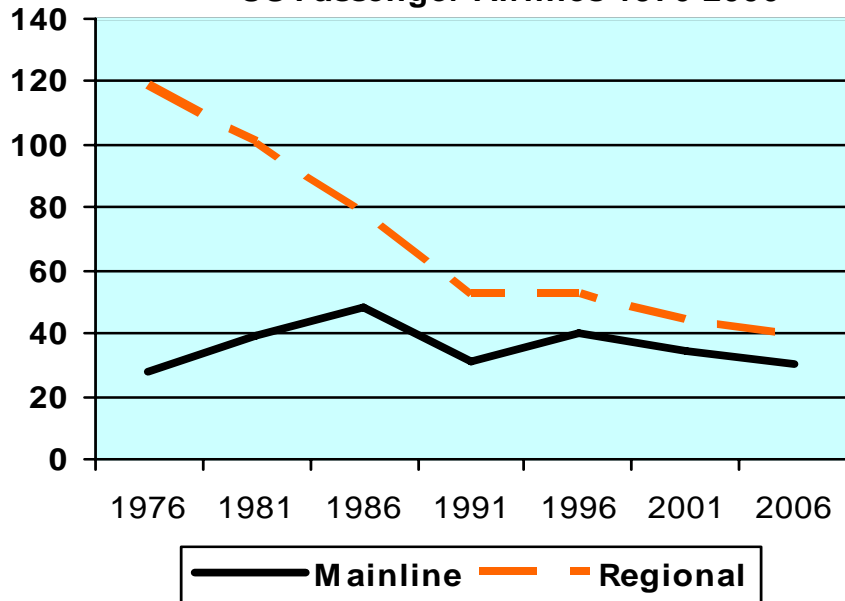


reality: airlines are not maturing/declining

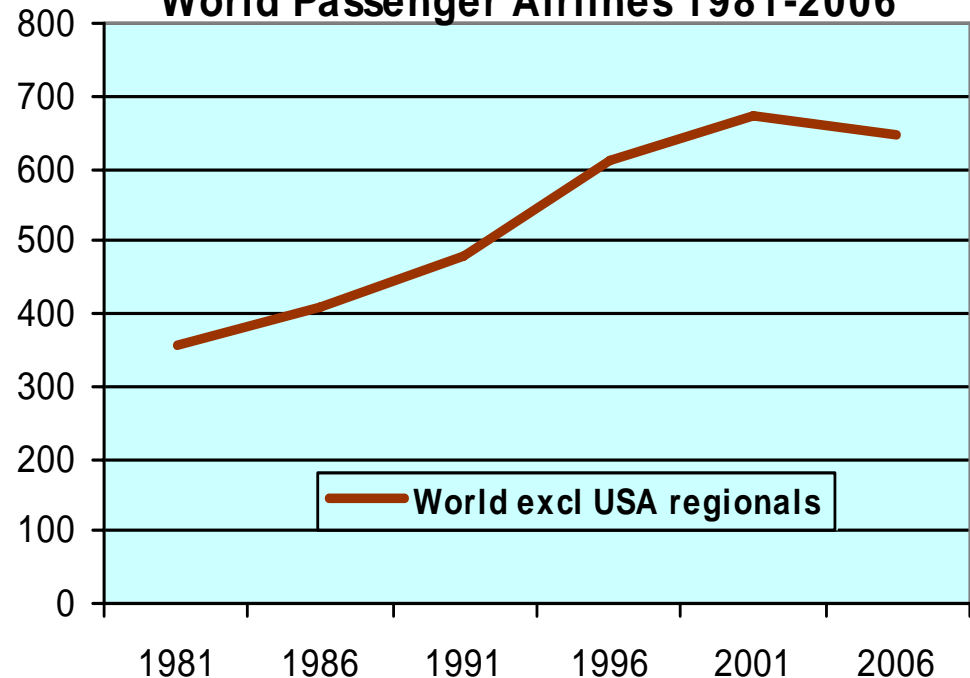
- Potential for productivity gains far from exhausted
- Longhaul/international markets especially vibrant

In a growing industry, mergers help reduce consolidation

US Passenger Airlines 1976-2006



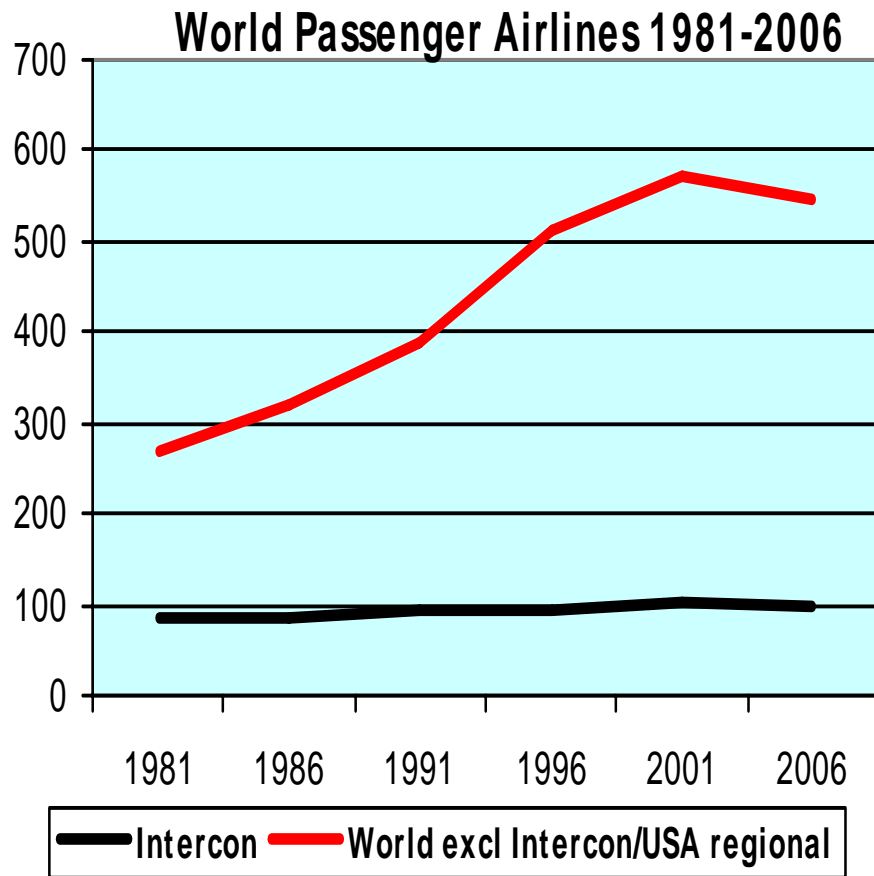
World Passenger Airlines 1981-2006



■ Dynamic churn (not consolidation)

- 107 US mainline carriers, 77 gone, overall stable
- 409 European carriers, 203 gone, overall increasing

Two separate industries— Intercon vs. all other airlines



- **Intercon structure stagnant despite huge demand growth**
- **No “dynamic churn” due to huge entry/exit barriers**
 - protected “National Champions”
 - cross-border barriers

Three huge obstacles to real cross-border freedom

Entrenched Safety/Legal Systems

- Regulators: safety/legal protections depend on worldwide system of “national” airlines

Entrenched Political Obstacles

- Politicians: support for “national champions”
fear of “foreign ownership”

Entrenched Competitive Barriers

- Intercon Airlines: Barriers to competitive entry much more important greater capital flexibility

Is consolidation inevitable?

- **Won't drive productivity gains or future industry growth**
 - No Cross-border airpolitical revolution
- **Airlines are not maturing/declining**
- **Mergers can work but usually don't**
- **Won't solve the real problems**
 - Restructuring unprofitable capacity
 - Barriers to market exit, reallocating capital

Who is arguing that “consolidation is inevitable”?

Biggest Intercon airlines in biggest markets

- United, Air France, Lufthansa, IATA, EU

Intercon consolidation>> Anti-competitive

- stagnant sector, huge entry barriers, big government role

Arguments totally inappropriate to Intercon

- No access to capital; can't make money; too small to compete
- Too many airlines, too much entry, too much competition
- EU-US cross-ownership>>more new jobs than DL+CO

Intercon consolidation would threaten industry growth

North Atlantic	1989	1999	2006	2009(?)
# of Airlines >1%	27	20	10	6
Top 2 Share (overall) excl UK/EI (72% of tot)	20%	24% 30%	57% 65%	72% 87%

EU policy shift to favor collusion/concentration since 2002

- End of competition between LH and SK/OS/LX/LO/TP/TK
- Air France-KLM merger; push to control US carriers
- PR push for new wave of mergers (UA-CO)

Risks to capital efficiency, consumers

- Distort competition with WN, B6, U2, FR
- Kills market discipline, “dynamic churn”